MOODY'S INVESTORS SERVICE

Rating Action: Moody's downgrades Ericsson's ratings to Ba2; outlook negative

Global Credit Research - 25 Oct 2017

London, 25 October 2017 -- Moody's Investors Service has today downgraded to Ba2 from Ba1 the corporate family rating (CFR) of Telefonaktiebolaget LM Ericsson (Ericsson), a leading global provider of telecommunications equipment and related services to mobile and fixed network operators, while changing the ratings outlook to negative from stable.

Concurrently, Moody's has downgraded Ericsson's probability of default rating (PDR) to Ba2-PD from Ba1-PD, the senior unsecured long-term ratings to Ba2 from Ba1 and the senior unsecured medium term note (MTN) program rating to (P)Ba2 from (P)Ba1.

"The downgrade to Ba2 with a negative outlook reflects our expectation that Ericsson's operating profit and free cash flow in 2017 and 2018 will continue to be negative, due to rising restructuring charges and provisions," says Alejandro Núñez, a Moody's Vice President -- Senior Analyst and lead analyst for Ericsson. "We believe that the turnaround of Ericsson's business and operating performance will take longer than previously anticipated with no expectation of a meaningful recovery until late 2018 at the earliest."

A full list of affected ratings can be found at the end of this Press Release.

RATINGS RATIONALE

The downgrade reflects Moody's view that the company's turnaround period will extend well into 2018 and will be longer than previously anticipated. It also reflects the sustained negative near- and medium-term financial implications that will arise in 2017-2018 from the company's restructuring charges and provisions, as announced by the company in the first half of 2017, as well as the continued weakness in operating profits that Moody's anticipates over the next year.

Following Ericsson's Q3 2017 results, Moody's expects sustained (reported) revenue declines of around 10% in 2017 and in the mid-single digits in 2018 in percentage terms (contrasted with a 10% contraction in 2016 and 8% reported revenue growth in 2015), along with negative free cash flow generation for a fourth consecutive year in 2018. During its Q3 2017 results, the company announced that its restructuring program expenses for full-year 2017 would be in the range of SEK9.0 billion - SEK10.0 billion, up from the SEK3.0 billion of restructuring charges for full-year 2017 announced in January 2017.

Although Moody's expects that Ericsson's operating margin (Moody's-adjusted, including restructuring charges and provisions) will continue to be negative in 2018 (at just below zero), the pace of decline in the company's key credit metrics over the coming year should diminish. Assuming a constant debt level and including the effects of the recently announced restructuring and provisions charges, Ericsson's gross debt-to-EBITDA ratio (Moody's-adjusted) will decline in 2018 to around 4x from 15x in 2017. However, credit metrics could weaken further if additional provisions or restructuring charges materialize since only 13 out of 42 underperforming contracts (primarily in Managed Services) have been renegotiated to date.

While recognizing that the company's turnaround phase will persist during most of 2018 meaning there will be further weakness in operating and credit metrics during that period, Moody's views positively the fact that the company continues to invest in R&D for the long term in key areas -- such as Networks and IT & Cloud -- in order to remain sustainably competitive particularly before the advent of the 5G cycle.

Despite the company's publicly stated financial policies, its relatively high exposure to the competitive wireless networking equipment market without sufficiently offsetting earnings contribution from other market segments, coupled with its revenue headwinds and uncompetitive cost structure, will continue to hamper Ericsson's ability to exhibit credit characteristics consistent with an investment-grade profile over the next two years.

The Ba2 ratings reflect: (1) Moody's expectation that the company's revenue and earnings growth will remain negative in 2017 and 2018, driven by soft market demand during a cyclical trough, as well as intense competition amid gradual structural shifts in the telecom networking equipment market's competitive and technological landscape; (2) the revenue and earnings drag from the company's sub-scale IT & Cloud and

Media divisions that further reduces the cyclically weak earnings in the Networks division; (3) the structural challenge that Ericsson faces because of its high exposure to the wireless networking equipment market which is unlikely to see material growth before 2020 as the next technology investment cycle (5G) is expected to ramp up more significantly around 2020; and (4) the company's weakening financial profile, due to its relatively high cost base and declining revenue, leading to significantly lower operating earnings and continued negative free cash flow generation. Furthermore, the unpredictable development of pending questions from US authorities regarding Ericsson's anti-corruption program and specific cases represents an event risk that further constrains the rating in the short to medium term.

These negative considerations are offset by: (1) Moody's expectation that the company's cost-saving activities will help stabilize its operating earnings by 2019; (2) the company's good liquidity position; (3) financial policies (including dividend payments) within the limits of the company's free cash flow generation and liquidity resources; and (4) a track record of shareholder support. Moody's considers Ericsson's good liquidity and main shareholders' support to be the company's two principal supportive credit factors during this period of cyclical and structural challenges.

RATIONALE FOR NEGATIVE OUTLOOK

The negative outlook reflects our views and expectations that:

(1) Ericsson's core market weakness is likely to extend into 2018 following our expectation of a 10% (reported) revenue contraction in 2017;

(2) This weakness will likely translate into additional restructuring charges and/or provisions, beyond those announced to date, that would require further cash outflows over the next two years;

(3) The company will report high gross leverage in 2017 of around 15x (Moody's-adjusted), which is expected to improve in 2018 toward the 4x area;

(4) Operating margins (Moody's-adj., including restructuring charges and provisions) and free cash flows will be negative in 2017 and 2018.

WHAT COULD CHANGE THE RATING UP/DOWN

Negative pressure could be exerted on Ericsson's ratings if: (1) the company reported a 2018 negative operating margin (Moody's-adjusted, including restructuring charges and provisions) similar to or worse than the 2017 level (-6%); and/or (2) there were no material improvement in gross leverage in 2018 from the 2017 level (15x); and/or (3) the company's competitive position diminished, particularly in the core Networks division, as the 5G investment cycle approaches; and/or (4) the company registered a further material decline in its internal liquidity sources; and/or (5) a material fine were to be imposed as a result of pending questions from US authorities.

Given the negative outlook, a rating upgrade over the short to medium term is unlikely. However, over time, upward rating pressure could develop if: (1) the announced restructuring program were to start yielding results, leading to a sustainable recovery in the company's operating performance such that its operating margin were to consistently be at least in the high single-digit percentage range; (2) the company were to better diversify its earnings base, which is currently highly exposed to the cyclical and highly competitive wireless networking equipment market; (3) Ericsson demonstrated a sustainably robust competitive position and technological leadership; (4) end-market demand were to rebound quicker than currently anticipated, into the positive revenue growth territory over a 12-month horizon; (5) free cash flow were to be materially and sustainably positive; and (6) Ericsson's own liquidity sources were to improve materially from currently projected 2018 levels such that the company reported a higher net cash position (including pension deficit) and reduced gross leverage from the currently high levels.

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Diversified Technology Rating Methodology published in December 2015. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

LIST OF AFFECTED RATINGS

Downgrades:

..Issuer: Telefonaktiebolaget LM Ericsson

.LT Corporate Family Rating, Downgraded to Ba2 from Ba1

.Probability of Default Rating, Downgraded to Ba2-PD from Ba1-PD

.Senior Unsecured Medium-Term Note Program, Downgraded to (P)Ba2 from (P)Ba1

.Senior Unsecured Regular Bond/Debenture, Downgraded to Ba2 from Ba1

Outlook Actions:

..Issuer: Telefonaktiebolaget LM Ericsson

....Outlook, Changed To Negative from Stable

Telefonaktiebolaget LM Ericsson (Ericsson) is a world-leading provider of telecommunication equipment and related services to mobile and fixed-network operators globally. The company's equipment is used by over 1,000 networks in more than 180 countries and around 40% of the global mobile traffic passes through its systems. In the nine months to 30 September 2017, the company's Networks division represented 74.4% of group revenue, followed by IT & Cloud at 21.3% and Media at 4.3%. The company's revenue is geographically well diversified across all major regions, with North America, Europe & Latin America, Asia and Middle East/Africa/Other each representing approximately 25% of group revenues. The company's revenues in the last twelve months (LTM) to 30 September 2017 were SEK209.3 billion. The company's largest shareholders are Investor AB and AB Industrivärden, with voting rights of 22.2% and 15.2%, respectively.

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